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NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

THESIS

**INTERNAL USERS AND USES OF
FINANCIAL STATEMENTS WITHIN THE
FEDERAL GOVERNMENT**

by

Rex T. Aman

June 2012

Thesis Advisors:

Douglas A. Brook
Danny Matthews

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**INTERNAL USERS AND USES OF FINANCIAL STATEMENTS
WITHIN THE FEDERAL GOVERNMENT**

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Submitted in partial fulfillment of the
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MASTER OF BUSINESS ADMINISTRATION

from the

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ABSTRACT

The purpose of this thesis is to determine the extent to which executives and program managers within the 24 major Chief Financial Officer (CFO) Act agencies utilize federal financial statements, contained within their Performance and Accountability Reports (PARs) or Agency Financial Reports (AFRs), to make better decisions or manage better. Studies to date indicate that most of the benefits have occurred within the financial management domain: better internal controls, improved financial systems, and more accurate and timely financial information. Additionally, clean audit opinions have resulted in reputational benefits for agency CFOs and their finance departments. To date, however, little has apparently been done to address how these financial statements and audit processes can most effectively be used. Using data obtained from the 24 major CFO agencies, along with three external perspectives, this thesis explores the internal users and uses of financial statements within the federal government to see if there is evidence that higher order benefits are being realized, namely the use of financial statements by executives and managers within the federal government for improved decision making and managing.

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LIST OF ACRONYMS AND ABBREVIATIONS

| | |
|---------|---|
| AFR | Agency Financial Report |
| AGA | Association of Government Accountants |
| AID | Agency for International Development |
| APR | Annual Performance Report |
| CFO | Chief Financial Officer |
| CFO Act | Chief Financial Officers Act of 1990 |
| CIGIE | Council of the Inspectors General on Integrity and Efficiency |
| DCFO | Deputy Chief Financial Officer |
| DLA | Defense Logistics Agency |
| DoD | Department of Defense |
| DoJ | Department of Justice |
| DoDIG | Department of Defense Inspector General |
| DON | Department of Navy |
| ERP | Enterprise Resource Planning |
| FFMIA | Federal Financial Management Improvement Act of 1996 |
| FASAB | Financial Accounting Standards Advisory Board |
| FIAR | Financial Improvement and Audit Readiness |
| FIP | Financial Improvement Plan |
| GAAP | Generally Accepted Accounting Principles |
| GAO | Government Accountability Office |
| GMRA | Government Management Reform Act of 1994 |
| GPRA | Government Performance and Results Act of 1993 |
| HHS | Department of Health and Human Services |
| HUD | Department of Housing and Urban Development |
| MD&A | Management's Discussion and Analysis |
| NDAA | National Defense Authorization Act |
| OMB | Office of Management and Budget |
| OUSD(C) | Office of the Under Secretary of Defense Comptroller |
| PAR | Performance and Accountability Report |
| P.L. | Public Law |
| SBR | Statement of Budgetary Resources |

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I. INTRODUCTION

A. PURPOSE

The purpose of this research is to determine the extent to which executives and program managers within the 24 major Chief Financial Officer (CFO) Act agencies utilize federal financial statements, contained within their Performance and Accountability Reports (PARs) or Agency Financial Reports (AFRs), to make better decisions or manage better.

B. BACKGROUND

The Department of Defense (DoD) and Department of Navy (DON) are investing heavily in achieving financial auditability and eventually an unqualified audit opinion. Approximately \$300 million is being applied annually on DoD Component Financial Improvement and Audit Readiness (FIAR) activities, excluding Enterprise Resource Planning (ERP) resources (DoD, 2011). DoD is committed to having fully auditable financial statements by 2017, the deadline established by Congress in the National Defense Authorization Act (NDAA) of 2010. In addition, Secretary of Defense Panetta has set ambitious goals for achieving auditability, including having an auditable Statement of Budgetary Resources (SBR) by 2014.

Given these commitments, the question must be asked, “What will be the benefits to DoD from this effort?” To answer one aspect of this question, a closer examination of uses and users of financial statements within the federal government is undertaken in an effort to better understand the role financial statements play in decision making and management. Only after the uses and users of financial statements are fully understood can we expect to gain full benefit from their production within DoD.

Managing financial resources accurately and reliably requires that executives and program managers have useful, accurate and timely financial information for leading and managing day-to-day operations within their agencies. In pursuit of these financial goals, President George H.W. Bush signed the CFO Act into law in November of 1990. The purposes of the CFO Act were three-fold:

- Bring more effective general and financial management practices to the federal government...
- Provide for improvement, in each agency of the Federal Government, of systems of accounting, financial management, and internal controls to assure the issuance of reliable financial information...
- Provide for the production of complete, reliable, timely and consistent financial information for use by the executive branch of the Government and the Congress in the financing, management, and evaluation of Federal programs. (CFO Act, 1990, §102b)

As part of the CFO Act, a formal Chief Financial Officer was established within each of the 23 major federal agencies. (The Department of Homeland Security was later added.) Table 1 lists the major organizations that are now subject to the CFO Act. According to the CFO Act (and the subsequent Government Management Reform Act of 1994 [GMRA]), each agency CFO is required to:

develop and maintain an integrated agency accounting and financial management system, including financial reporting and internal controls, which...provides for...complete, reliable, consistent, and timely information which is prepared on a uniform basis and which is responsive to the financial information needs of agency management. (CFO Act, 1990, §902{a}3)

Similarly, the Government Accountability Office (GAO) (1991) states, “Several of the CFO Act’s requirements aim to improve the financial information available to agency managers, the Congress and others” (p. 14).

| | |
|---|---|
| Department of Agriculture | Department of Transportation |
| Department of Commerce | Department of Treasury |
| Department of Defense | Department of Veterans Affairs |
| Department of Education | Environmental Protection Agency |
| Department of Energy | National Aeronautics and Space Administration |
| Department of Health and Human Services | Agency for International Development |
| Department of Homeland Security | General Services Administration |
| Department of Housing and Urban Development | National Science Foundation |
| Department of Interior | Nuclear Regulatory Commission |
| Department of Justice | Office of Personnel management |
| Department of Labor | Small Business Administration |
| Department of State | Social Security Administration |

Table 1. Twenty-four federal agencies subject to CFO Act

As part of the effort to improve financial management, the production of financial statements was initiated under the CFO Act and further codified by the GMRA. Accordingly, Title 31, United States Code, has been amended to read as follows:

Sec. 3515. Financial statements of agencies

(a)(1) Except as provided in subsection (e), not later than March 1 of 2003 and each year thereafter, the head of each covered executive agency shall prepare and submit to the Congress and the Director of the Office of Management and Budget an audited financial statement for the preceding fiscal year, covering all accounts and associated activities of each office, bureau, and activity of the agency.

(b) Each audited financial statement of a covered executive agency under this section shall reflect

(1) the overall financial position of the offices, bureaus, and activities covered by the statement, including assets and liabilities thereof; and

(2) results of operations of those offices, bureaus, and activities [31 USC, §3515]

Sec. 3521. Audits by Agencies

(e) Each financial statement prepared under section 3515 by an agency shall be audited in accordance with applicable generally accepted government auditing standards—

(1) in the case of an agency having an Inspector General appointed under the Inspector General Act of 1978 (5 U.S.C. App.), by the Inspector General or by an independent external auditor, as determined by the Inspector General of the agency; and

(2) in any other case, by an independent external auditor, as determined by the head of the agency. [31 USC, §3521]

The overall objective of the federal financial statement audit is an expression of an opinion on whether the financial statements are fairly presented, in all material respects, in conformity with the generally accepted accounting principles (GAAP) (CFO Council and the Council of the Inspectors General on Integrity and Efficiency (CIGIE), 2007). There are four types of opinions that can be expressed by an auditor: Unqualified, Qualified, Disclaimer, and Adverse.

Unqualified, or clean, audit opinions are an indication of sound financial management. According to the CFO Council and the CIGIE (2011), an unqualified opinion means that an independent auditor finds that the financial statements “are fairly presented in all material respects, in accordance with GAAP used to prepare and present the financial statements” (p. 13). Efforts to obtain clean opinions within the federal government are ongoing. As of FY 2011, 21 of the 24 CFO agencies received an unqualified audit opinion.

The Department of Homeland Security (DHS) and the State Department received qualified opinions in FY 2011—meaning an independent auditor found that the financial statements contained at least one material misstatement and/or the agency being audited had not complied with GAAP in all material respects. Except for the qualification of a particular issue, the rest of the financial statements give a fair view (“Qualified Audit,” 2012).

The last major CFO agency, the Department of Defense (DoD), received a disclaimer in FY 2011. That is, an independent auditor was unable to render an opinion on DoD’s financial condition due to an inability to gather the evidence necessary to

determine that the material matters were fairly presented to support an unqualified opinion. A disclaimer is issued when there is any type of material irregularity that the auditor is unable to reconcile (“Disclaimer of,” 2012).

The last type of opinion, an adverse opinion, is effectively the opposite of an unqualified opinion. An adverse opinion means that an independent auditor finds the financial statements contain significant misstatements and/or significantly deviate from GAAP. No CFO agencies received an adverse opinion for FY 2011.

Notwithstanding the CFO agencies’ audit opinions, questions remain regarding the utility of these financial statements. The question of who uses the federal financial statements and for what purpose is not well-defined. For instance, the Association of Government Accountants (AGA) (2007) reports that, “many financial professionals do not think the types of financial statements used by the private sector and required by the CFO Act are right for the federal government” (AGA, 2007, p. 10).

Arguments for corporate-style financial statements drew heavily on private-sector analogies. Within the private sector, privately held companies are required to produce annual financial statements, consisting of a balance sheet, income statement, a statement of cash flows, and a statement of changes in stockholders’ equity. The uses and users of private-sector financial statements are relatively easy to discern. The principal uses and users in the business sector can be grouped as follows:

- For investment information: Existing and potential investors and lenders, analysts, and rating agencies may use the information to assess financial condition and make decisions about financial participation.
- For business decisions: Existing and potential suppliers, customers, venture partners, competitors, and labor unions may use financial reports to assess the risks in doing business with the firm, to identify opportunities, and to benchmark their own performance.
- To evaluate management: Boards of directors, investors, and management itself may use audited financial reports as a tool to assess management performance and to compare performance with peer organizations.
- To manage financial issues: Boards of directors and management may use financial reports to identify issues of risk and opportunities based upon

significant year-to-year changes, long term liabilities or cash position, or current annual payments on long-term debt, for instance.

- To identify policy issues: Policy analysts and advocates, politicians, and media interested in issues associated with the firm may use financial statements for information related to executive compensation, international activities, profit levels, etc. (Brook, 2011, pp. 7–8)

Within the public sector, on the other hand, users and uses of financial statements are less clear. The Federal Accounting Standards Advisory Board (FASAB) identifies the users of federal financial statements as citizens, Congress, executives, and program managers, and considers managers the primary users of “cost” information because they are responsible for carrying out program objectives with the resources entrusted to them (FASAB, 1997). IBM’s government consultants see the users of federal financial statements as senior leadership, program managers, financial managers and analysts (IBM Business Consulting Services, 2005).

Users of federal financial statements can therefore be grouped into two categories based on their position relative to the specific organization, either internal or external. Citizens and Congress would be considered external, while executives and program managers would be internal users. Because one of the stated goals of the CFO Act was to bring more effective financial management practices to the federal government, the focus of this research will be exclusively on internal users: executives or senior leadership (e.g., program agency heads and their deputies, under, and assistant agency heads; heads of bureaus, departments, agencies) and program managers. According to David (2002), “policy, program and operating officials (and their staffs) require timely, accurate, reliable, consistent and useful financial information for day-to-day operating, strategic, investment and policy decision and action” (p.11). Similarly, according to FASAB (1997), “Providing this information to program managers [and] executives... is essential to planning and conducting government functions economically, efficiently, and effectively...” (p. 30).

Executives and program managers want information to help them assess how well their agency is doing by answering questions regarding such topics as:

- Budgetary integrity: What legal authority was provided for financing government activities and for spending the monies? Were the financing and spending in accordance with these authorities? How much was left?
- Operating performance: How much do various programs cost, and how were they financed? What outputs and outcomes were achieved? What and where are the important assets, and how effectively are they managed? What liabilities arose from operating the program, and how will they be liquidated or provided for?
- Stewardship: Did the government's financial condition improve or deteriorate? What provision was made for the future?
- Systems and Control: Does the government have cost-effective systems and controls to safeguard its assets? Is it able to detect likely problems? Is it correcting deficiencies when detected? (FASAB, 2007, p. 11)

Executives focus at the strategic level on plans and programs that are intended to achieve presidential and congressional goals. In particular, they pay attention to budgets that provide the resources necessary to achieve those goals. Additionally, executives are concerned about the management of programs—with the delivery of services and process efficiency/effectiveness—and with program manager performance. Executives are also responsible for providing information that will facilitate presidential and congressional oversight (FASAB, 2007).

Program managers focus at the operational level on plans, programs, and budget execution. They recommend future program budgets and ensure existing programs remain within the budget authority granted by Congress. They ensure that program resources are acquired economically, maintained adequately, and used efficiently. Additionally, program managers need periodic information about the status of budgetary resources—the extent to which the resources remain available for use or reprogramming. To avoid overspending, program managers also need information about obligations incurred on their programs. To facilitate analysis of alternatives, information on the effectiveness of programs is also needed to make valid comparisons among competing programs (FASAB, 2007).

So, 22 years after the CFO Act was signed into law, are the corporate-style federal financial statements being used by executives and program managers within the 24 CFO

agencies? From the policy makers' perspective, financial statements were intended to be used to make better decisions and manage better. From the financial practitioners' perspective, however, that connection is less clear. Studies to date indicate that most of the benefits have occurred within the financial management domain: better internal controls, improved financial systems, more accurate and timely financial information. Clean audit opinions have resulted in reputational benefits for agency CFOs and their finance departments (Brook 2010, 2011). The goal of this thesis is to determine if there is evidence that the benefits are moving beyond the financial management community. Are there higher order benefits being realized, namely their use by executives and managers within the federal government?

C. TERMINOLOGY

1. Financial Statement

The annual, audited financial statement of a reporting entity as described in Section 3515 of Title 31 of the United States Code and OMB Circular No. A-136. Financial statements consist of:

- Management's Discussion and Analysis
- Balance Sheet
- Statement of Net Cost
- Statement of Changes in Net Position
- Statement of Budgetary Resources
- Statement of Custodial Activity, if applicable
- Statement of Social Insurance, if applicable
- Related Note Disclosures
- Required Supplementary Stewardship Information, if applicable
- Required Supplementary Information (RSI) (OMB, 2007, p.4)

2. Financial Reporting

According to FASAB (1997), financial reporting is:

The process of recording, reporting, and interpreting, in terms of money, an entity's financial transactions and events with economic consequences for the entity. Reporting in the federal government also deals with nonfinancial information about service efforts and accomplishments of the government, i.e., the inputs of resources used by the government, the outputs of goods and services provided by the government, the outcomes and impacts of governmental programs, and the relationships among these elements. (p. 14)

Similarly, OMB (2004) stated:

Financial reporting includes annual financial statements of an agency as well as other significant internal or external financial reports. Other significant financial reports are defined as any financial reports that could have a material effect on a significant spending, budgetary, or other financial decision of the agency or that is used to determine compliance with laws and regulations on the part of the agency. (p. 22)

3. Financial Information

Any information or data that could have a material effect on a significant spending, budgetary, or other financial decision of the agency or that is used to determine compliance with laws and regulation of the part of the agency. Financial information includes both financial statements and financial reporting as described above.

D. RESEARCH QUESTIONS

The thesis asks this primary research question: Are the corporate-style federal financial statements being used by executives and program managers within the 24 CFO agencies?

In addition, the research asks these secondary research questions: Who are the internal users of the financial statements within the 24 CFO agencies? What are the internal uses of the financial statements within the 24 CFO agencies?

E. METHODOLOGY

To determine the extent to which corporate-style financial statements are being used by decision-makers and managers, the 24 CFO agencies are studied. Specifically, the FY 2011 PAR/AFRs of the CFO agencies are first examined to see what they self-report about users and uses of the financial statement information. Secondly, a small number of in-depth telephone interviews were conducted with experts external to the CFO agencies to determine their views on the issue. Lastly, surveys and/or interviews are conducted with senior financial managers from the major CFO agencies to ask their opinion on users and uses of financial statements.

F. THESIS ORGANIZATION

There are four chapters that follow this introductory chapter. Chapter II is the literature review, which presents earlier studies and findings on the usefulness of financial statements with the federal government. Chapter III identifies the methodology used to generate the data, information and observations needed to determine the extent to which executives and program managers within the 24 CFO agencies utilize federal financial statements, contained within their PAR/AFRs, to enhance decision-making and improve overall management. Chapter IV presents the data from each of the three sources. Chapter V summarizes the findings, suggests recommendations for further study, and concludes the thesis.

II. LITERATURE REVIEW

Chapter II addresses previous findings on the user and uses of corporate-style financial statements within the federal government. It begins by claiming that these annual financial statements are improving the way that federal agencies conduct their financial management—one of the original benefits advanced by proponents of the CFO Act. This chapter then describes the difficulty CFO agencies face when attempting to use financial statements for decision making. A detailed look at what related government entities external to the CFO agencies think about corporate-style financial statements' current users and uses follows. Next, a small sample of reported usages within the federal government is discussed. The chapter concludes with a discussion on the relevance to DoD and DON financial improvement initiatives and the importance of determining the actual level of use within the CFO agencies.

A. THE CLAIM

Advocates of corporate-style financial statements insist that such statements help executives and managers make better decisions and manage better. As established in Chapter I, the goal of the CFO Act (and subsequent GMRA) is to ensure that performance information (including financial) is both useful and used in decision making. To ensure that performance information will be both useful and used, it must meet the needs of various users for completeness, accuracy, validity, timeliness, and ease of use (Dodaro, 2011). Obtaining a clean audit opinion, which 21 of the 24 CFO agencies have done, presumably satisfies the requirements for completeness, accuracy and validity. What remains is the question of timeliness and ease of use. OMB Comptroller Linda Combs testified that the CFO Council and the President's Council on Integrity and Efficiency "will work together... to determine... if the data are timely and in the right format for decision making" (Combs, 2007, p. 5).

B. FINDINGS TO DATE

There is little literature directly concerned with the topic of users and uses of corporate-style financial statements within the federal government. A common thread

among the existing literature is that there appears to be an absence of well-defined internal users or uses of the financial statements within the CFO agencies. From the beginning, Jones and McCaffery (1993) asserted, “Notwithstanding the experience of a few agencies with audited financial statements, their practical utility has not yet been proven...” (p. 71). Now, nearly 20 years later, those same sentiments are still being echoed by organizations within the federal financial management community.

1. GAO

According to GAO (2008), an assessment of the 24 CFO agencies for fiscal year 2007 “illustrate that many agencies still do not have effective financial management systems, including processes, procedures, and controls in place that can routinely produce reliable, useful, and timely financial information that federal managers can use for day-to-day decision-making purposes” (p. 3).

As recently as 2011, GAO has still been unable to establish a concrete link between financial reports and decision making within many federal agencies. According to a recent report released by GAO (2011a), “the IRS continues to face challenges in developing and institutionalizing the use of financial information to assist it in making operational decisions and in measuring the effectiveness of its programs” (p. 16). The question then arises, “Are the financial statements a part of this *financial information*, or are they merely products of the same financial systems and processes that produce this financial information?”

2. AGA

A 2005 AGA survey reports that some interviewees of the CFO community “pointed out that customers simply do not value, much less read, the information in financial statements” (AGA, 2005, p. 18). Two years later, another AGA (2007) report finds that, on a scale of 1 to 7, financial executives gave the value of data in federal financial statements to making business and program decision a score of only 2.7. According to one interviewee, “financial statements are only important to the CFO and do not register high [with] the agency administrator or Congress Financial statements ... are ... not used to manage programs or make key decisions” (p. 12).

AGA's most recent annual survey of federal CFOs finds further dissatisfaction regarding the current model of annual financial reporting. Its results indicate that the financial system produces information that few consider relevant or useful, so that the current financial statements have little value (AGA, 2011). Some of the suggestions given by federal financial executives for changing the financial reporting model are most telling:

- Break information down by projects and programs, which would produce information of more value to program managers (and citizens).
- Report the information that stakeholders say they want.

These statements seem to endorse the practitioners' perspective presented above—that the financial statements are not directly useful in decision making. At a minimum, they suggest a deeper examination of users and uses of financial statements is warranted.

3. CFO Council

According to the CFO Council and the CIGIE (2011), the CFO Act (and subsequent GMRA) “improved the quality of financial information and financial reporting... [and] have contributed to the evolution of reliable, timely, and useful financial information in the Federal government. The preparation of audited financial statements assists CFOs and agency leadership in assessing and mitigating enterprise risk” (p. 12). This statement implies that it is the process of creating these corporate-style financial statements, and not the statements themselves, which currently has value within the federal government.

Regarding the issue of users, the CFO Council and the CIGIE (2011) found that,

The demand by stakeholders for financial reporting beyond the principal financial statements has also evolved... Analyzing financial statements requires an in-depth understanding of government accounting principles, and most financial and performance reports contain details that may only appeal to the financial management community. In the continuing quest to improve government financial reports and ensure data accuracy, the financial management community should increase efforts to make

financial information more relevant to all of its stakeholders, including decision-makers, program managers, and the public. (p. 4)

4. Others

David Walker, former U.S. Comptroller General, in testimony to Congress noted that,

By the end of my term as Comptroller General, I would like to see the civilian CFO Act agencies routinely producing not only annual financial statements that can pass the scrutiny of a financial audit, but also quarterly financial statements and other meaningful financial and performance data to help guide decision makers on a day-to-day basis. (GAO, 2007, p. 26)

This stated need for other products (e.g., quarterly financial statements) implies that the annual statements do not provide all the useful information necessary to internal users. Brook (2010) sums it up when he states, “[T]he uses and usefulness of improved financial information for non-financial managers in the federal government seem to be somewhat limited” (p. 63).

C. FIRST-ORDER BENEFITS OF FINANCIAL STATEMENTS

Prior research has shown that both financial statements and the audit process have had significant benefits with the federal financial management community. Charles Bowsher, former Comptroller General and one of the driving forces behind the passage of the CFO Act, testified that financial statements would assure the accounting systems, transactions, financial statements and financial reports are properly linked (Jones & McCaffrey, 2001). A GAO (2002) study of 26 federal agencies supported Mr. Bowsher’s claim,

The preparation and audit of financial statements increases accountability and transparency and are an important tool in the development of reliable, timely, and useful financial information for day-to-day management and oversight. Preparing audited financial statements also leads to improvements in internal control and financial management systems. (p. 1)

Studies to date indicate that most of the benefits have occurred within the financial management domain: better internal controls, improved financial systems, more accurate and timely financial information. Additionally, clean audit opinions have

resulted in reputational benefits for agency CFOs and their finance departments (Brook 2010, 2011). This research aims to determine if there is evidence that these benefits are moving beyond the financial management community. Are there higher order benefits, namely their use in decision making by executives and managers within the federal government, which are now being realized? A few CFO agencies have begun to report a link between auditable financial reports and management decision-making, but those links have been in predominantly broad and ambiguous terms (Brook, 2010). For example, according to the Department of Education (2007), “The Department consistently produces accurate and timely financial information that is used by management to inform decision making and drive results in key areas of operation” (p. 17). Similarly, the National Science Foundation (NSF) (2007) reports that “sound financial management enables NASF to pursue critical investments in science and engineering research and education... [and provides] reliable and timely financial information to support sound management decisions” (p. II-1).

On the surface, these statements may seem like endorsements for financial statements; however, the question must again be asked, “Are the financial statements a part of this *financial information*, or are they merely products of the same financial systems and processes that simultaneously produce the financial information the Department of Education and NSF are referring to?” Answering these sorts of questions will allow for a better understanding of the true users and uses of the auditable financial statements.

D. DOD’S FINANCIAL IMPROVEMENT AND AUDIT READINESS (FIAR) PLAN

The FIAR Plan, which provides the pathway to agency-wide financial audit readiness, is DoD’s comprehensive working guidance for financial management improvement. According to the original FIAR published in December 2005, the purpose of the FIAR is to establish a roadmap to improve internal controls, resolve material weaknesses, and advance DoD’s fiscal stewardship (DoD, 2005).

The goals of the FIAR are based on supporting the OUSD(C) priority objective to “improve business and financial processes, controls, systems and data to achieve accurate, reliable and timely financial and managerial information for decision makers and citizens” (DoD, 2010, p. 1). Efforts to achieve these goals focus on processes, controls, and systems supporting information most often used in managing the DoD. By prioritizing budgetary information, both the objective of improving information most often used in managing the DoD and the goal of obtaining auditable financial statements will be accomplished (DoD, 2010).

The most recent DoD FIAR Plan Status Report does not provide the detailed FIAR plans of the Military Departments, Defense Agencies, and DoD Components because the DoD Components are in the midst of revising their audit readiness plans, as directed by the Secretary of Defense, to meet his newly established goals. Through an October 13, 2011 DoD-wide memorandum, Secretary of Defense Panetta directed the department to accelerate key elements of the FIAR Plan and place greater emphasis on the overall effort (i.e., achieving the FIAR priorities and auditable financial statements). Specifically, Secretary Panetta called for the department to:

- Achieve audit readiness of the SBR by the end of calendar year (CY) 2014
- Increase emphasis on accountability of assets
- Execute a full review of the Department’s financial controls over the next two years and establish interim goals against which to assess progress
- Ensure mandatory training for audit and other key financial efforts, and establish by the end of CY 2012 a pilot certification program for financial managers--similar to the one now in place for acquisition managers
- Appropriately resource efforts to meet these goals
- Meet the legal requirements to achieve full audit readiness for all DoD financial statements by 2017 (DoD, 2011, p. I-1)

The Secretary’s memorandum also directed the Services to revise their FIAR Plans to incorporate the accelerated date of 2014 for the SBR. In addition to maintaining

the same FIAR strategy and methodology, the top two FIAR priorities as established in 2009, also remain the same. These priorities are: budgetary information and mission critical asset information.

1. Budgetary Information

The Department bases major financial decisions on budgetary data (e.g., status of funds received, obligated, and expended). Therefore, the first priority of the FIAR Plan focuses on process improvements, controls, and systems associated with budgetary information. This is the starting point for achieving the goal of obtaining auditable financial statements, beginning with the SBR. The benefits of focusing improvement efforts on budgetary information and the SBR are:

- Better and reliable visibility of budgetary transactions resulting in more effective use of limited resources
- Operational efficiencies through more readily available financial information
- Improved fiscal stewardship (ensures that funds appropriated, expended, and recorded are reported accurately, reliably, and timely)
- Effective budget processes and controls (precludes deficient budget practices and reduces Anti-Deficiency Act violations) (DoD, 2011, p. I-2)

2. Mission Critical Asset Information

The second FIAR Plan priority focuses efforts on information essential to the effective management of the Department's mission critical assets. This information also is required to support financial statement audits and includes:

- Individual Item Identifier (e.g., unique item identifier, aircraft tail number, ship number, and real property unique identifier)
- Category/Asset Type (e.g., aircraft – airlift fixed-wing)
- Location (e.g., military installation/base)
- Operational Status (e.g., active, closed, disposed)
- Item Description (e.g., building headquarters, base library)

- Controlling/Financial Reporting Organization (DoD, 2011, p. I-2)

By making mission critical asset information a priority, the Department is ensuring that asset information important to decision makers is accurately recorded. Accomplishing this priority improves important management information and moves DoD closer to auditability (DoD, 2011).

3. Pushing Ahead

Within two days of the release of Defense Secretary Panetta's memorandum, OUSD(C) established the following deadlines for the Services:

- Provide revised plans for achieving an auditable SBR to Secretary Panetta by December 13, 2011
- SBR audit readiness assertion by the end of June 2014
- Validation of SBR assertions by September 30, 2014
- Audit of the FY 2014 DoD Combined SBR to begin by the end of CY 2014 (DoD, 2011, p. I-3)

This accelerated goal for achieving an auditable SBR in 2014 is based upon significant past and recent audit opinions, ongoing audits, and audit readiness accomplishments. For FY 2011, the following department entities have obtained an unqualified audit opinion:

- U.S. Army Corps of Engineers–Civil Works
- Defense Contract Audit Agency
- Defense Commissary Agency
- Defense Finance and Accounting Service
- Military Retirement Fund
- Office of the Inspector General
- TRICARE Management Activity - Contract Resource Management (DoD, 2011, p. II-1)

Progress continues to be made in accomplishing the priorities of budgetary and mission critical asset information, as demonstrated by recent audit readiness assertions including:

- Air Force asserted in Quarter 3 of FY 2011 existence and completeness audit readiness of Cruise Missiles and Aerial Targets/Drones.
- TRICARE Management Activity, Service Medical Activity, Defense Advanced Research Projects Agency, and Chemical Biological Defense Program asserted audit readiness of Appropriations Received in Quarter 4 of FY 2011. (DoD, 2011, p. II-1)

4. Enterprise Resource Planning (ERP)

One of the FIAR goals is to attain compliance with Federal Financial Management Improvement Act (FFMIA) of 1996, which requires financial systems to comply with:

- Federal financial system requirements
- Federal accounting standards
- U.S. Standard General Ledger at the transaction level (DoD, 2011, p. II-8)

Key to achieving FFMIA compliance and producing auditable financial statements is the modernization of the Department's business and financial systems environment. During FY 2011, DoD made progress in the retirement of legacy systems that do not comply with FFMIA, and many more are expected to be retired in FY 2012. The Navy recently received an Acquisition Decision Memorandum that approved its planned deployment of the Navy ERP to the Fleet Industrial Supply Center and Naval Sea System Command field activities. As a result, the Navy anticipates 63 legacy systems being retired in FY 2012; this is in addition to the 19 systems recently retired (DoD, 2011).

5. Timeline

The Army, Air Force, and other Defense organizations are revising their FIARs to achieve an auditable SBR in FY 2014 and full audit readiness in FY 2017, as directed by the Secretary of Defense. Figures 1 and 2 show the path each Service will take in order

to meet this deadline. The Army is expected to achieve audit readiness of its SBR in FY 2014, and its mission critical assets in FY 2015. The Navy is expected to achieve audit readiness of its SBR in FY 2014, and its mission critical assets in FY 2015. The Air Force is expected to achieve audit readiness of its SBR in FY 2014, and mission critical assets in FY 2017. The Defense Logistics Agency (DLA) SBR is expected to be audit ready in FY 2014, and mission critical assets will be audit ready in FY 2015.

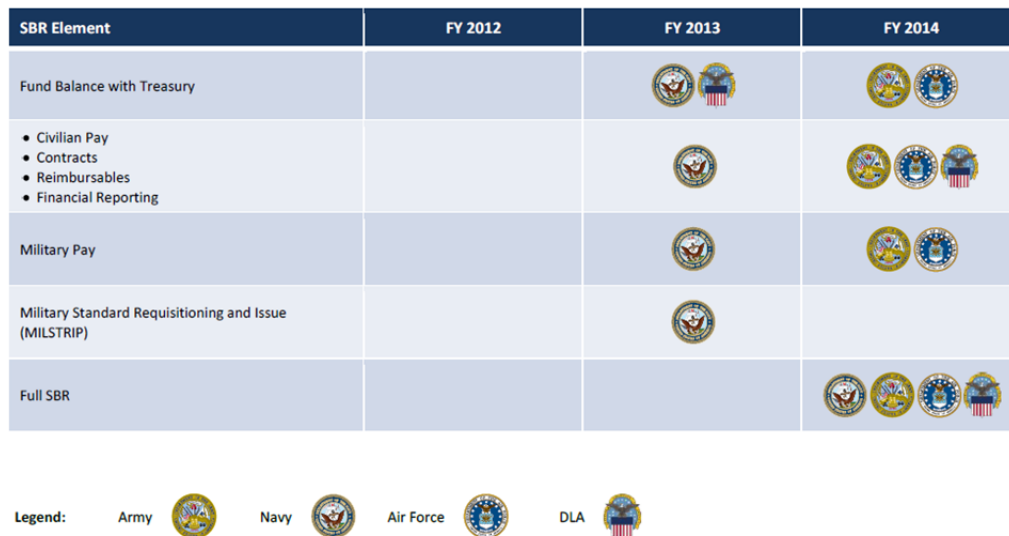


Figure 1. Timeline to SBR auditability (From DoD, 2011, p. III-2).

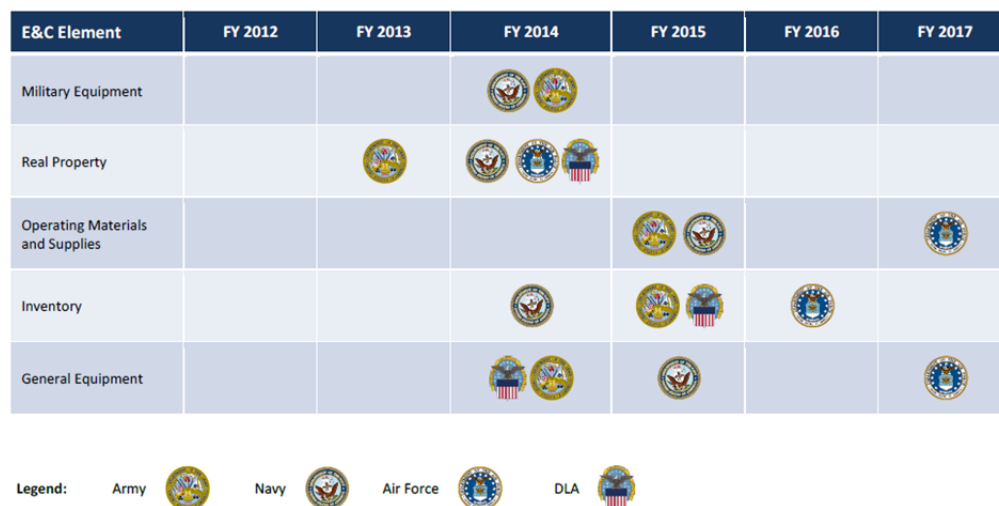


Figure 2. Audit readiness validation completion target dates for key elements of mission critical asset existence and completeness (From DoD, 2011, p. III-3).

Displayed slightly differently, Figure 3 depicts DoD’s FIAR Strategy in terms of four waves. This strategy balances the need for short-term accomplishments (Wave 1) against the long-term goal of achieving an unqualified audit opinion (Wave 4). This strategy is consistent with the USD(C) priorities. The first three waves (performed concurrently) focus on both budgetary information and mission critical asset information. Once reporting entities achieve audit readiness (Waves 1, 2, and 3), they should commence Wave 4, audit readiness activities. This strategy provides coverage of all financial statements, while prioritizing and improving information most often used by DoD management. Furthermore, the four waves will lead to interim milestones and ultimately to a full financial statement auditability (DoD, 2011).



Figure 3. Prioritized waves to achieve full financial statement audits
(From DoD, 2011, p. 5).

E. DON’S FINANCIAL IMPROVEMENT AND AUDIT READINESS (DON FIAR) PLAN

The stated goal of DON’s FIAR (formerly Financial Improvement Plan, or FIP), as a subset of DoD’s FIAR, is to produce financial information with greater accuracy, reliability, and accessibility that will facilitate the department’s senior leaders ability to allocate the department's resources in a better informed, more precise way (“Financial improvement,” n.d.). Figure 4 shows a more detailed blueprint for how DON plans to achieve auditability of its SBR by 2014, as mandated by Defense Secretary Panetta. This accelerated goal for achieving an auditable SBR is based upon significant past and recent audit opinions, ongoing audits, and audit readiness accomplishments.

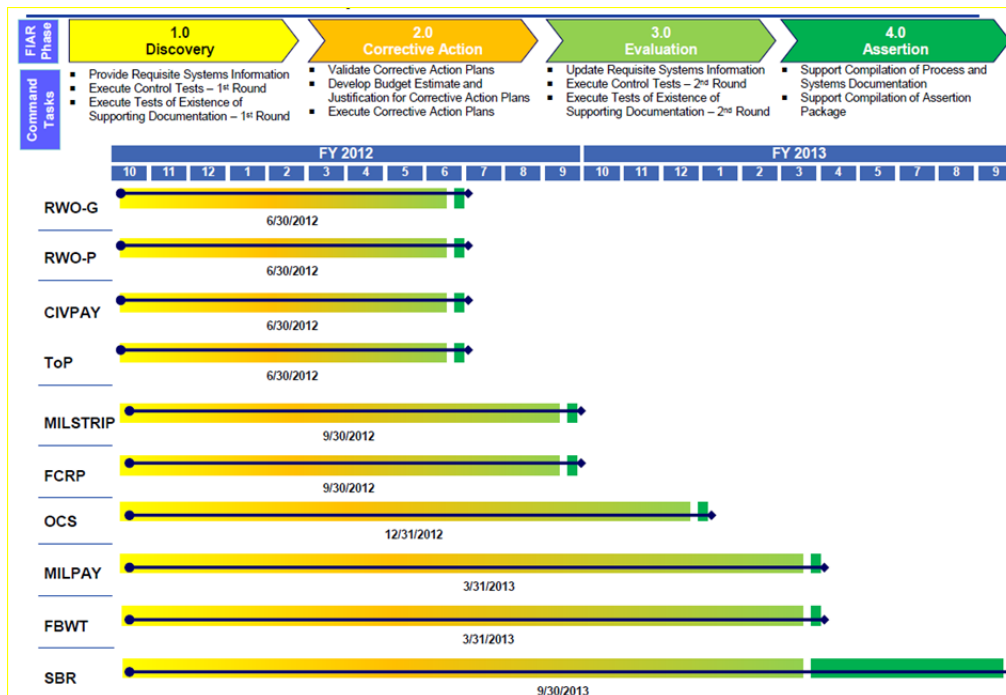


Figure 4. DON's SBR Assertion Roadmap (Available at http://www.fmo.navy.mil/documents/Divisions/FMO4/5_DON_SBR_PoAM_Roadmap.pdf).

1. Marine Corps

The Marine Corps has led DON's audit efforts from the beginning and those efforts continue today. The goal was to achieve a favorable audit opinion on the FY 2011 SBR, but the need for additional test sampling, plus time limitations, ended this second-year effort without an opinion. However, given the significant progress made, the DON and the Department of Defense Inspector General (DoDIG) agreed that these efforts should be capitalized on and an audit of the Marine Corps' FY2012 SBR should commence as soon as practical (Work & Commons, 2012).

The Marine Corps' experience has been valuable to the rest of DON as it seeks to achieve SBR audit readiness. According to Work and Commons (2012), the Marine Corps has developed essential financial management capabilities for the first time (i.e., reconciling cash with the Treasury's balance) and has constructed an effective audit response infrastructure "enabling the rapid collection and transmission of large volumes of business process documentation to auditors for analysis" (p. 3). Additionally, the

Marine Corps is executing an aggressive corrective action plan for business process and system deficiencies identified during its audit process that has produced instructive lessons for DON (Work & Commons, 2012).

2. Other DON Advancements

The Department of the Navy has achieved other notable audit readiness accomplishments. In 2011, DON achieved a favorable audit opinion on its Appropriations Received process. In January 2012, the DoDIG completed an examination and verified that the processes and systems used to establish Existence and Completeness of ships, submarines, Trident missiles, and satellites inventories are also audit ready. A similar inspection of DON's aircraft inventory management is currently in progress (Work & Commons, 2012).

A second examination is also underway, focusing on the E-2D Hawkeye Major Defense Acquisition Program. In Quarter 4 of FY 2011, the Navy asserted the program's audit readiness (DoD, 2011). This examination will determine whether the acquisition program's business processes and systems meet audit standards. This test carries added significance because the E2-D program has been executed solely within Navy ERP. As such, the results will reflect not only the effectiveness of E2-D program, but also that of Navy ERP (Work & Commons, 2012).

DON's planned implementation of ERP at six major commands, which began in FY2008, will conclude next fiscal year. Besides that major initiative, DON is currently focusing on two other major objectives: assessing ERP's ability to meet financial audit standards; and making improvements in its utility. According to Work & Commons (2012), "a methodical effort is underway to standardize the execution of business processes within Navy ERP across our diverse user population" (p. 5).

F. IMPORTANCE

The federal government has spent over twenty years and a countless amount of money in an effort to reform its financial management systems and practices. One of the stated benefits advanced by proponents of the CFO Act was that the resulting set of financial statements would be used internally by the CFO agencies to make better decisions and manage better. If these financial statements turn out to have no such value, that information must be considered in planning for future financial reporting requirements within the federal government (Brook, 2010).

G. CHAPTER SUMMARY

This chapter began by explicitly stating the claim advanced by proponents of the CFO Act—that these annual, corporate-style financial statements are improving the way the federal agencies conduct financial management business. The chapter then discussed the problems that the CFO agencies are currently facing with regards to such financial statements, mainly that they are not timely and are too aggregate. Relevant findings from AGA, GAO, the CFO Council, and others on the internal usage of these statements were presented next. These suggest that there are currently no well-defined users and uses of corporate-style financial statements within the 24 CFO agencies at this time. Next, a small sample of reported usages within the federal government was discussed. More analysis must be conducted, however, to determine the extent to which these annual financial statements actually played a role in such assertions of better financial decision making. Finally, the chapter concluded with a discussion on the relevance of financial statements within DoD and DON's financial improvement initiatives and the importance of determining the actual level of use within the CFO agencies.

III. METHODOLOGY

A. INTRODUCTION

Three approaches were taken to generate the data, information and observations needed to determine the extent to which executives and program managers within the 24 CFO agencies utilize federal financial statements, contained within their PAR/AFRs, to enhance decision-making and improve overall management. Using more than one research technique provided opportunities to test and illustrate the findings of each approach. First, phone interviews were conducted with senior executives from three organizations external to the CFO agencies: AGA, GAO, and Grant Thornton, LLP, one of the major, independent auditing firms used to audit federal financial statements. These interviews were employed at the beginning of this research to help identify and frame the issues at hand and to generate data and information pertaining to the question of users and uses of financial statements. Second, an extensive review of the FY 2011 PAR/AFRs was conducted to examine if the CFO agencies self-reported any internal uses and users of their financial statements. Third, interviews and/or surveys were conducted with senior financial managers within the major CFO agencies to get their perspectives on internal users and uses of financial statements.

B. EXTERNAL AGENCIES

1. GAO

GAO's perspective was sought because of its continued involvement with federal financial reporting. GAO annually audits the consolidated financial statements of the U.S. government to ensure that Congress and the President have reliable, useful, and timely financial and performance information to make sound decisions and conduct effective oversight of federal government programs (GAO, 2011b). Additionally, GAO works closely with OMB and Treasury to oversee FASAB, which initially established accounting and financial reporting standards for the federal government and has since developed the applicable accounting principles for the financial statements (FASAB, 2010). It therefore seemed imperative to include its perspective on the topic.

2. AGA

AGA considers itself the “thought leader and catalyst for change” within government finance professionals working in federal, state and local governments as well as the private sector and academia (“Strategic goals,” n.d.). Their objectives are to:

- Identify, monitor, assess and influence emerging issues
- Enhance research to produce timely, valuable content for key stakeholders
- Cultivate knowledge and disseminate effective practices across disciplines and levels of government
- Provide valued input on standards and to policy-makers

AGA’s viewpoint was included to gain the practitioners’ perspective on these issues and because of the fluid nature of this research topic. Although the CFO Act was signed into law 22 years ago, its implementation and implications are still not fully realized.

3. Grant Thornton, LLP

Grant Thornton is one of the major independent auditing firms of CFO agencies’ financial statements. Auditing firms play a major role in an agency’s ability to achieve an unqualified audit opinion. Grant Thornton’s viewpoint was included to gain another perspective on the question of users and uses of financial statements and to help frame the research question.

C. PAR/AFR REVIEW

The CFO Act, as amended by the GMRA, requires the major 24 agencies of the Federal Government to prepare and submit audited financial statements. According to OMB (2011),

Under the Reports Consolidation Act of 2000 (P. L. No. 106-531), agencies are permitted to submit combined reports in implementing statutory requirements for financial and performance management reporting to improve the efficiency of Executive Branch performance. These reports are combined in the PAR, which consists of the Annual

Performance Report required by the Government Performance and Results Act (GPRA) (P. L. No. 103-62) as amended, by the GPRAMA with annual financial statements and other reports, such as agencies' assurances on internal control, accountability reports by agency heads and IGs' assessments of agencies' most serious management and performance challenges. PARs provide financial and performance information that enables the President, the Congress, and the public to assess the performance of an agency relative to its mission and to demonstrate accountability. (p. 12)

Agencies may choose either to produce a consolidated PAR or to produce a separate AFR and APR (OMB, 2011). For FY 2011, seven CFO agencies chose to produce a consolidated PAR: Department of Agriculture, Department of Commerce, Department of Justice, National Aeronautics and Space Administration, National Regulatory Commission, Social Security Administration and the Department of Veterans' Affairs. The remaining 17 agencies chose to produce separate AFRs and APRs. Regardless of choice, each report was analyzed for any self-reporting uses or users of financial statements.

D. CFO AGENCY INTERVIEWS

A generic survey (see Appendix) was electronically sent to senior financial managers (CFOs/DCFOs) at each of the 24 CFO agencies to get their perspectives on internal users and uses of financial statements. Additionally, CFO agencies which self-reported any link within their AFR/PAR, regardless of strength, between their financial statements and decision making or managing were sent an additional questionnaire specifically addressing that linkage. In some instances, these surveys were conducted over the phone to facilitate participation. Of the 24 agencies asked to participate in this project, 13 (or 54 percent) chose to contribute their thoughts on this topic of users and uses of financial statements.

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IV. DATA

A. INTRODUCTION

Three approaches were taken to generate the data, information and observations needed to determine the extent to which executives and program managers within the 24 CFO agencies utilize federal financial statements, contained within their PAR/AFRs, to enhance decision-making and improve overall management. First, phone interviews were conducted with senior executives from three organizations external to the CFO agencies: AGA, GAO, and Grant Thornton, LLP. Second, an extensive review of the FY-2011 PARs/AFRs was conducted to examine if the CFO agencies self-reported any internal uses/users of their financial statements. Third, surveys and/or interviews were conducted with senior financial managers within the major CFO agencies to get their perspectives on internal users/uses of financial statements.

B. EXTERNAL INTERVIEWS

Each of the three external organizations was asked their opinion on the degree to which the major CFO agencies' executives and program managers use financial statements in decision-making or managing. With few exceptions, the overwhelming response from all three organizations was that they knew of no well-defined uses or users of financial statements within the CFO agencies. One interviewee stated, "You'd be hard pressed to find somebody who actually has some piece of data on a financial statement that's something that they use for managing." Similarly, another respondent stated, "I don't think anybody is using them, because financial statements have become a one size fits all document that covers everything and in essence provides no information for anyone to make decisions." Reasons for their limited usefulness can be categorized into some common terminology. The major terminological themes include:

- Data is too aggregate or high-level
- Data is not timely enough
- Statements are difficult to read and understand - Many executives and program managers do not have a financial management background

One respondent did list two possible segments of the financial statements that may be useful to managers as the Statement of Budgetary Resources (SBR) and Statement of Net Cost. Managers may be interested in the SBR because it shows information such as their budget authority, obligated versus unobligated funds, and outstanding cash outlays. Looking at the SBR would allow managers to see where they stood at the end of fiscal year. Similarly, Net Cost information would allow managers to view program costs. This data, however, is historical in nature and still very aggregate, and managers require more detailed and timely financial information. As one respondent put it, “If you really wanted to know something about a particular issue you could go find it, but I don’t know what decision you’re going to make based on the financial statements.”

While all three external organizations agreed that financial statements have limited utility in decision making at best, they did agree that generating the audited financial statements has value in the following sense: Sound financial systems, as evidenced by a unqualified audit opinion on the financial statements, verifies that the quality of the financial information is acceptable and the business processes and controls in place that produce this information are reliable. As a result, the information that comes out of these financial systems can be relied upon, even if the financial statements themselves are not useful. One interviewee stated,

There is great value in the process of putting the financial statements together. You’re ability to produce clean financial statements is indicative that your systems and processes are working correctly. We are constantly depending on these financial systems to generate [other] reports we need. Although we may not use the financial statements themselves, there are many other pieces of data that come out of the same financial system that are in fact essentials for managing the agencies. The financial statement is simply ‘the proof in the pudding.’ The idea is that once you have reliable systems in place that have been verified by clean financial statements, you can provide the detailed information managers want to see on their specific program.

All three organizations also agreed there remains a requirement for additional tools to help executives and managers manage more effectively. One interviewee stated, “We need to do something in addition to financial statements, because nobody reads

them.” Two such tools discussed were dashboards and other financial reports. Dashboards are essentially a computer-based financial information system that delivers near real-time information on an agency’s budgetary resources (apportionment, commitment, obligation, and expenditure) to executives and managers’ computer monitors. Other financial reports discussed included routine budget execution reports that effectively provide the same information as a dashboard—obligation, payment, and accrual status by appropriation, account, program/project—only in a hard copy form. It is important to remember, however, that the financial information for either of these two additional tools comes from the same financial systems that have been verified by receiving a clean audit opinion on the financial statements.

From the perspective of AGA, GAO, and Grant Thornton, financial statements themselves seemingly have little utility for executives and program managers as a whole in decision making and managing. It is clear, however, that the need for accurate and timely financial information remains essential for budgetary, cost analysis, program evaluation and other purposes. From the external perspective, this accurate and timely financial information can only be provided once the systems and processes that produce that information have been verified, as evidenced by an unqualified audit opinion on the financial statements.

C. AFRS/PARS

The FY 2011 PAR/AFRs of the 24 major CFO Act agencies were examined to see what the agencies self-reported about the uses and users of their financial statements. Most of the PAR/AFRs were silent on the issue. However, some did address the issue, largely in general, non-specific terms. For instance, the Agency for International Development reports “Preparing the Agency’s financial statements creates the opportunity to improve financial management and provide accurate, reliable information that is useful for assessing performance and allocating resources” (AID, 2011, p. 23). The Department of Education states “The Department consistently produces accurate and timely financial information that is used by management to inform decision-making and drive results in key areas of operation” (Department of Education, 2011, p. 27).

The statements in the agency AFRs can be categorized by some common terminology. The major terminological themes include: informing management decision making, linkage to budgeting and resource allocation, assessing performance, promoting management accountability, and supporting other financial reports. The Department of Health and Human Services (HHS) says, “The production of accurate and reliable financial information is necessary for making sound decisions, assessing performance, and allocating resources” (HHS, 2011, p. I-18). Some agencies cite the processes involved in audited financial reporting as a key element. The Department of Labor, for instance reports, “With [its] emphasis on internal controls accurate financial information delivery to key decision makers, and transparent and accountable reporting, the Department's stakeholders can be confident that resources are used efficiently and effectively” (Department of Labor, 2011, p. 24). Other agencies make reference to management reports based on financial information derived from the financial statements or from the related processes that produce more timely and accurate financial information. The Social Security Administration (SSA) explains, “The [financial] statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records (SSA, 2011, pp. 40–41). Similarly, USAID identifies such reports as “quarterly financial statements, financial statements at the operating division or program level, budget execution reports, reports used to monitor specific activities, and reports used to monitor compliance with laws and regulations” (AID, 2011, p. 30).

Thus, there is some evidence for the usefulness of financial reports for policy makers and managers but it tends to be non-specific. It remains unclear from analyzing the financial statements themselves that they are used for decision making and management. However, the timely and accurate financial information, associated with the processes and practices of audited financial reporting may have increasing usefulness for budgetary, cost analysis, program evaluation and other purposes.

D. CFO SURVEYS/INTERVIEWS

When asked if they consider financial statements themselves useful financial information for executives and managers, the responses were mixed. A handful of CFOs stated that the financial statements were useful for things such as:

- Providing a general “snapshot” of the financial condition of the organization at a specific point in time
- As a starting point for year to year comparisons and trend analysis (Department of Justice (DoJ), personal communication, April 10, 2012; State Department, personal communication, April 9, 2012; National Science Foundation (NSF), personal communication, April 10, 2012)
- Judging scope and true costs of operation vs. annual budgeted amounts (DoJ, personal communication, April 10, 2012)
- Providing a baseline for reconciling other more useful, internal reports on a periodic basis to provide confidence in internal accounting (Nuclear Regulatory Commission (NRC), personal communication, April 9, 2012)
- Broad program oversight, when paired with performance data (DoJ, personal communication, April 10, 2012)
- Monitoring annual growth/decline of liabilities for strategic planning (NSF, personal communication, April 10, 2012)
- Understanding program and control weaknesses (Department of Housing and Urban Development (HUD), personal communication, April 10, 2012)
- Referencing progress on various line items (e.g., property) (NSF, personal communication, April 10, 2012)
- Referencing footnotes as the agency engages the auditors throughout the year in preparation for the current year audit (NSF, personal communication, April 10, 2012)
- The “Notes” and “Management’s Discussion and Analysis (MDA)” can provide additional information to help readers better understand the financial statements (NRC, personal communication, April 9, 2012).

These uses are predominantly historical in nature. Given the fact that financial statements represent a snapshot in time, at the end of the fiscal year, this comes as no surprise. These uses speak little, however, to the financial statements’ utility in real-time

decision making. This represents the major downside of financial statements—that “they are ‘rear-view mirror’ oriented and most managers are dealing with current and future financial decisions” (Lofthus, personal communication, April 10, 2012).

When asked, “Thinking about your own organization’s annual financial statements and the systems/processes that produce them, do executives and managers outside of your financial management organization read and use the financial statements?” nearly every respondent immediately jumped to the importance financial statements play for external stakeholders—Congress, the President, OMB and Department of Treasury. They use financial statements (Statement of Net Cost and Statement of Budgetary Resources) to assess program costs and benefits and establish fiscal policy, including determination of governmental financing needs (Department of Agriculture, personal communication, April 17, 2012). Because this research is solely focused on internal users and uses of financial statements, it is enough to simply note here the tendency to focus on external stakeholders, even when asked to concentrate internally.

Regarding the usefulness of financial statements for current or forward-looking decision making, Mark Easton, Deputy CFO, OUSD(C), summarized the overwhelming sentiment of those surveyed best,

Financial statements, in and of themselves, are not particularly useful. It is because there is an established and longstanding set of auditing and accounting standards, along with GAAP, that have been applied to these kinds of statements...and that provides a financial representation of a given entity...that makes the statements themselves valuable. An audit of these statements provides an outside observer or stakeholder with assurance that the quality of the information is acceptable and the business processes (and associated controls) that produce this information are sound and reliable. As a result, you can rely on the information when used...even if you don’t really use the statements themselves.

For the public sector, this confidence is the most important outcome from these statements because I have never been convinced that public sector financial statements lend themselves to any kind of financial analysis by outside analysts....but maybe they will be at some point. For now, I’d say that the statements are pretty worthless, but the public trust from being

able to produce them and have them audited is ‘priceless.’ (Easton, personal communication, April 7, 2012)

Similarly, James Millette, acting CFO of the State Department stated,

[Financial statements’] primary usefulness within the agency is mostly a compliance exercise. From this perspective, most agencies, including State, have strengthened their internal controls and the financial statements can now be relied upon to reflect accurate information. However, their use for day-to-day decision making is limited. (Millette, personal communication, April 9, 2012)

One CFO went so far as to say, “I don’t personally use them for anything and I’m the CFO.” Yet another respondent stated, “Standing solely on its own, I have never found the actual financial statement document useful.” Reasons listed for why financial statements have limited use for day-to-day decision making included:

- Data is too aggregate. Users need more detailed financial information (NRC, personal communication, April 9, 2012; DoJ, personal communication, April 10, 2012; NSF, personal communication, April 10, 2012)
- Data is stale. Users need financial information on a more frequent basis (NRC, personal communication, April 9, 2012; DoJ, personal communication, April 10, 2012; NSF, personal communication, April 10, 2012)
- Formatting. Data is presented in a manner that makes it difficult to use. Users need to be able to access, sort, display, and compare data at the appropriation, program, or project level (State Department, personal communication, April 9, 2012; HUD, personal communication, April 10, 2012)
- Limited connection to budget (HUD, personal communication, April 10, 2012)

As James Millette (personal communication, April 9, 2012) detailed, “The needs of users of federal financial statements are far different than those of users of private company financial statements. Striking a balance to meet these needs is still a work in progress.” There is some evidence for the usefulness of financial statements for policy makers and program managers, but those uses tend to be mostly historical in nature. It remains unclear, however, that the financial statements themselves are useful for current

or forward-looking decision making and management. On the other hand, the timely and accurate financial information, associated with the processes and practices of audited financial reporting, as evidenced by unqualified audit opinions, have been shown to be of considerable usefulness for budgetary, cost analysis, program evaluation and other purposes.

Now that the majority of CFO agencies have an unqualified audit opinion, they have been able to produce other financial instruments which are updated monthly, weekly, or even daily to help guide executives and managers in decision making and managing. For many, this represents the greatest benefit of the audit process, while it simultaneously weakens the case for financial statements' utility in decision making. As Todd Grams, CFO of the Department of Veterans' Affairs stated,

There are numerous other sources of better information to drive improved performance and increased value at an agency. [I] would recommend they use other information and not invest time in trying to glean useful information from the statements. (Grams, personal communication, May 3, 2012)

NRC reported utilizing a number of such internal financial reports, including a monthly Budget Execution Report (BER), customized for different levels of management, by major NRC business lines, as well as by program offices that are updated daily to help guide NRC executives and managers in day-to-day operations. Collectively these reports provide managers a diagnostic capability to assess financial performance by tracking such things as:

- Monthly budget execution status of the current year and prior years' funds by NRC's fourteen offices and by NRC's seven major business lines.
- Utilization of current and prior years' resources by different funding categories (i.e., salary and benefit, contract support, travel, fee-based, general funds, and Commission funds).
- Trend analysis of commitment, obligation, and expenditure rates by NRC offices and major business lines.

Additionally, NRC reported the use of financial management dashboards on the desktops of executive managers' computers. With a single mouse click, daily updated

financial data generated from NRC's central accounting system is presented to the NRC senior managers, which provide a view of the current status of NRC's budgetary resources (apportionment, commitment, obligation, and expenditure) by program offices. For NRC, it is clear that financial statements serve two vital roles. First, they validate that the financial systems and processes NRC has in place are reliable and the financial information produced from those systems is accurate. Secondly, they provide a baseline for reconciliation on a periodic basis, thus providing NRC the confidence in their internal accounting reports used by the executives and managers for operational decision making (NRC, personal communication, April 9, 2012).

The State Department has developed what it coined a "data warehouse and reporting system" that it uses to monitor and control budgetary and other financial resources on a day-to-day basis. When needs are identified or help desk tickets warrant, State Department financial management staff designs and posts standard reports that are available to all users of the data warehouse to run on their own as needed. Such a data warehouse provides flexibility and allows users to create and run reports as they deem necessary (State Department, personal communication, April 9, 2012).

When asked, "How does your department use accurate and timely financial information to inform decision-making and drive results in key areas of operations?" the Department of Education reported adapting existing financial reporting practices to achieve the new enhanced reporting requirements of the American Recovery and Reinvestment Act (Recovery Act). Under this system, the Department of Education's Office of the Chief Financial Officer (OCFO) prepares a weekly Financial Activity Report which reports detailed cumulative obligations and outlays for each Recovery Act appropriation, as well as the weekly Funding Notification Report which provides detailed information regarding available Recovery Act funding. These weekly reports provide timely and transparent information to the Recovery.gov website. In addition to the reports used to support Recovery.gov, the Department of Education's OCFO produces a series of internal Recovery Act reports that are used to manage Recovery Act programs. These reports provide detailed information regarding apportionments, allotments, obligations, outlays, and available balance data by program activity and by state. Further,

OCFO prepares detailed weekly financial reports that are used to manage the Education Jobs Fund (Department of Education, personal communication, April 19, 2012).

Similarly, the National Science Foundation (NSF) reported using a multitude of internally-generated reports to help monitor budgetary resources, including reports generated from their Executive Information System and various Access reports (NSF, personal communication, April 10, 2012). Lastly, the Justice Department reported using a vast array of routine budget execution reports that show obligation, payment, and accrual status by appropriation, account, program and project. These reports became relied upon due to “routine use over many years, augmented by refinements made as we see where more granular data is useful to decision makers” (Lofthus, personal communication, April 10, 2012). Other agencies, such as HUD, are still looking for ways to maximize their return on investment. They have discussed internally looking for ways to make the financial information more useful, including more summaries and web-based delivery (HUD, personal communication, April 10, 2012).

It is important to note that, as with NRC, all of these agencies reported that without the ability to verify accurate financial information, these follow-on financial instruments would be worthless. Only when the data going into these financial instruments can be verified as accurate and reliable can the output of these instruments be considered useful for decision makers. The current financial statement reporting model and independent audit process provide credibility and confidence in financial operations and information, allow for consistent and timelier reporting, and foster discipline throughout the financial management arena (Chief Financial Officers Council and the CIGIE, 2011).

As James Millette (personal communication, April 9, 2012) identified, “The value from annual financial statements comes from the fact they provide a rigorous and hopefully reliable basis for an agency’s entire financial framework.” Similarly, Thomas Skelly, acting CFO of the Department of Education stated,

Financial statements are produced directly from and are directly reconcilable to the general ledger. Similarly, financial information produced by OCFO that is used by management for decision-making, such

as that produced for the Recovery Act and the Education Jobs Fund, is derived directly from and is directly reconcilable to the general ledger. As such, this financial information is consistent with the Department's financial statements. (Skelly, personal communication, April 19, 2012)

E. CHAPTER SUMMARY

This chapter began by introducing the three approaches taken to generate the data, information and observations needed to determine the extent to which executives and program managers within the 24 CFO agencies utilize federal financial statements, contained within their PAR/AFRs, to enhance decision-making and improve overall management. The chapter then presented the relevant data obtained from phone interviews conducted with senior executives from three external agencies: AGA, GAO, and Grant Thornton, LLP. This information was used to help identify and frame the issues at hand and to generate data and information pertaining to the question of users and uses of financial statements. Next, this chapter presented a review of the major CFO agencies' FY-2011 PARs/AFRs, to examine if they self-reported any internal uses/users of their financial statements. Lastly, this chapter presented the pertinent segments of interviews and/or surveys conducted with senior financial managers within the CFO agencies, to get their perspectives on internal users/uses of financial statements.

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V. RESULTS, RECOMMENDATIONS AND CONCLUSIONS

This chapter answers the primary and secondary research questions using the data provided in Chapter V, provides recommendations for future studies, and concludes the thesis.

A. ANSWERING THE RESEARCH QUESTIONS

The following research questions are answered:

1. Are the Corporate-Style Federal Financial Statements being Used by Executives and Program Managers within the 24 CFO Agencies?

Yes and no. There is some evidence for the usefulness of financial statements for executives and program managers. The uses of financial statements as identified in Chapter IV by senior financial managers within the CFO agencies can be categorized within the framework developed in Chapter I.

- Budgetary integrity:
- Judging scope and true costs of operation versus annual budgeted amounts
- Operating performance:
- Broad program oversight, when paired with performance data
- Monitoring annual growth/decline of liabilities for strategic planning
- Referencing progress on various line items
- Stewardship:
- Providing a general “snapshot” of the financial condition of the organization at a specific point in time
- Year to year comparisons and trend analysis
- Systems and Control:
- Understanding program and control weaknesses
- Other:

- Providing a baseline for reconciling other more useful, internal reports on a periodic basis to provide confidence in internal accounting
- Referencing footnotes as the agency engages the auditors throughout the year in preparation for the current year audit
- The “Notes” and “MDA” can provide additional information to help readers better understand the financial statements

Framing these responses in such a way illustrates that the financial statements have utility in helping executives and program managers assess how well their agency is doing. However, these uses are predominantly historical in nature and do not address financial statements’ usefulness in current or forward-looking decision making and management. On the other hand, the timely and accurate financial information, associated with the processes and practices of audited financial reporting, as evidenced by unqualified audit opinions, have been shown to be of considerable usefulness for budgetary, cost analysis, program evaluation and other purposes. These results are not necessarily bad or unexpected. As James Millette indicated,

[Financial statements] will never have utility for program managers or even CFOs in making day-to-day decisions. That is not their purpose. The department-level statements are a snapshot of the prior year status of an agency’s finances. They offer very high level information. They offer the ability to compare and contrast data from multiple past years. They can show certain high level trends. They do not, and are not intended to, answer questions on the current financial status of an agency, a program, a project, etc. (Millette, personal communication, April 9, 2012)

Their inability to help make decisions or manage more effectively does not necessarily show a failure on the part of financial statements. Rather, it demonstrates that our federal financial management systems are maturing. If one considers these results in terms of a three step process as depicted in Figure 5, the majority of CFO agencies are more than two-thirds of the way to maturation. In general, they have (1) improved the quality/integrity of their business processes and (2) confirmed the results of those business processes by receiving an unqualified audit opinion from an independent

auditing firm. What remains is (3) applying that information differently—in a more useful way that maximizes the return on investment (DoD, personal communication, April 7, 2012).

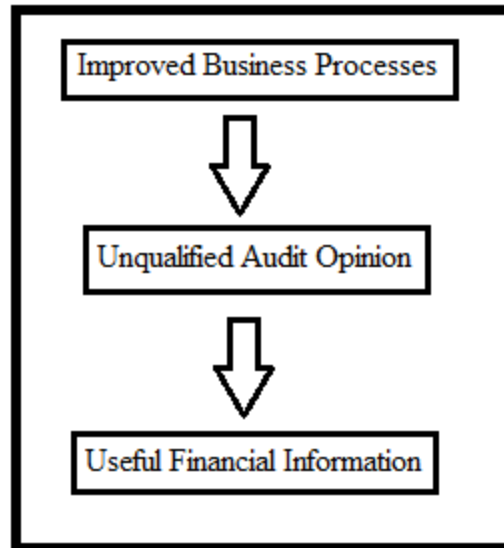


Figure 5. Step financial information maturation process (After DoD, personal communication, April 7, 2012),

Federal financial managers must continue to identify ways to improve the financial reporting model and make it even more useful to stakeholders and responsive to their ever changing needs. The federal financial management community is working towards reports and tools that will provide more timely information to lay users, align information similar to Recovery Act reporting, provide real-time financial information and interactive internet-based delivery methods, and improve budget data reporting (DHS, 2012). Owen Barwell, acting CFO of the Department of Energy, may have said it best:

There are things we can do with existing financial statements that would better serve operating in a public environment and better serve the constituents. We can add to what we currently have [in order to] add richness to the information currently being provided. [If we can] add to the financial statements and show them where the money is going, what

you're getting in terms of performance; add audits of Internal Control or Enterprise Controls...that would add to the value of producing these financial statements.

[The key moving forward is] making our investment sweat. Now that we have these good financial systems in place, business practices and process are pretty stable, we have a good control environment...how do we capitalize on that and start generating information for decision makers so they can actual make effective decisions? The externality here is the budget environment we are in. That [pressure] is actually forcing our managers and executives to pay attention to the financial data [for the first time]. (Barwell, personal communication, April 10, 2012)

From a DoD perspective, this statement has major implications. First, it stresses the importance of receiving an unqualified audit opinion. Although DoD has a long way to go in this regard, there will be eventual long-term benefits. DoD will be unable to reap the higher order benefits of improved financial management—namely the production of other financial instruments, based on accurate and reliable financial information, that are useful for decision making and managing—until it is able to achieve such an opinion.

Secondly, DoD will have to determine its own, unique set of users and uses of financial information and how it can best “make its investment sweat.” Obtaining an unqualified opinion means only that one of the fundamental problems of financial management was solved, but in order to manage more effectively there is much more that must be done (Candrea, 2004). Although this thesis has discussed a number of such users and uses of financial information within other CFO agencies, those results are particular to each agency. Historically, DoD's financial systems and processes have been developed to support the budget and appropriations process. As a result, they have not generated the type of financial information that meets the needs of the Department's decision makers (Candrea, 2004). Only after DoD understands the wants and needs of its own executives and program managers can it hope to create the kinds of financial instruments that will be most effective in decision making and managing.

2. Who Are the Internal Users of the Financial Statements within the 24 CFO Agencies? What Are the Uses of the Financial Statements within the 24 CFO Agencies?

Internally, financial statements can be used to gain or convey a very high level or “big picture” view of the financial status of the agency. Generally speaking, the Balance Sheet and the Statement of Net Cost are seen as the most useful segments of the financial statements, as they provide a high level view of an agency’s major assets, liabilities, and net cost by major program. Additionally, given their historical nature, financial statements may be useful as a starting point for year-to-year comparisons or trend analysis.

From the CFO down, the thing that internal users are most concerned with is accurate, timely, and reliable financial information that aids in the decision making process. As such, they see financial statements’ main purpose as a compliance exercise. An unqualified audit opinion on the financial statements verifies that the quality of the financial information is acceptable and the business processes and controls in place that produce this information are reliable. As a result, the information that comes out of these financial systems can be relied upon to aid in decision making, even if the financial statements themselves are not useful.

B. RECOMMENDATIONS FOR FURTHER STUDY

Studies may be derived from this thesis to further understand the role financial statements play in decision making and managing within the federal government. Each of these studies is described below.

1. External Stakeholders

This thesis focused solely on internal users and uses of financial statements. A study may be performed to determine the uses and users of financial statements external to the CFO agencies, namely Congress and Citizens.

2. Financial Instruments Used by Other CFO Agencies

As previously discussed, a number of agencies have already begun to use individually tailored financial instruments to meet the decision-making support requirements of their executives and program managers. A study may be performed to determine how those instruments were deemed necessary, how they were created, and how they are being used.

C. CONCLUSIONS

This thesis has looked into the internal users and uses of financial statements in order to help better understand their role in decision making within the federal government. Through a comprehensive literature review and data collection process, a greater understanding of financial statements' utility can now be realized.

APPENDIX. GENERAL QUESTIONNAIRE

One of the stated goals of the CFO Act was the production of “complete, reliable, timely and consistent financial information for use by the executive branch of the Government and the Congress in the financing, management, and evaluation of Federal programs.”

Thinking about your own organization’s annual financial statements and the systems/processes that produce them:

- 1.) Do you consider financial statements themselves useful financial information for executives and managers? Why or why not?
- 2.) Do executives and managers outside of your financial management organization read and use the financial statements?

If so,

- a.) What part(s) of the financial statements do they use?
- b.) Do the financial statements require manipulation or are they useful “as is”?
- c.) How do they use the financial statements? (i.e., for what purpose (budgetary control, decision making, cost information, etc.)?)

If not,

- d.) Could executives and managers in your organization use the financial statements? Specifically, how? For what purpose?
- e.) Who might be the most likely users?
- f.) Are there ways the financial information associated with the financial statements could be made useful to executives and program managers?

Your PAR/AFR contains the following excerpt, “... the [financial] statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.”

- 3.) What reports are you referring to here?
- 4.) How did you determine that these reports were needed/useful?
- 5.) Who uses these reports?
- 6.) Can you provide us with samples of some of these reports?
- 7.) Is there anything that I have not asked, or an area that I have left unexplored, that would be relevant to this discussion?

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